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The State of Global Governance: An Assessment

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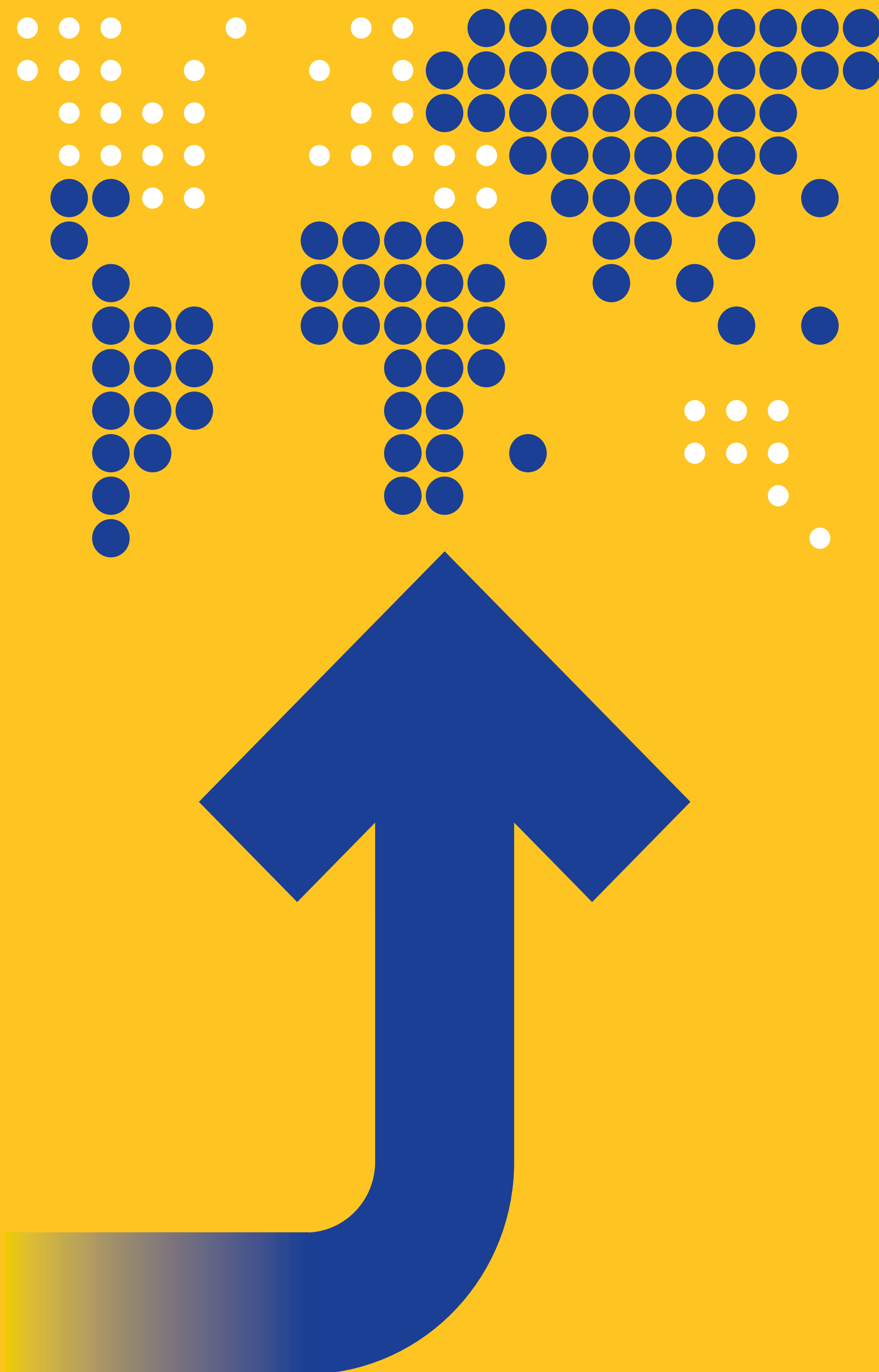
Background Paper



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Introduction

It is well established that the degree of interconnectivity between countries has increased enormously over the past two decades. Since interconnectedness means the actions of one country affect other countries, this has also increased the need for global governance to encourage independent sovereign nations act in a manner likely to produce better global outcomes for all. This paper assesses the effectiveness of the current institutions of global governance in three key areas of interconnectivity: international financial markets, international trade and global warming caused by the build up of carbon emissions arising from the burning of fossil fuels.

In exploring this issue, it is useful to distinguish between two different approaches to global governance. The first focuses on "hard governance" based on treaty based inter governmental institutions, which work to establish agreed rules of behaviour, together with some agreed mechanism to enforce the rules, or at least to incentivise compliance. Examples of such formal treaty based organizations are the Security Council, the WTO, the IMF, the World Bank and the UNFCCC. The second is "soft governance" which involves governments agreeing to cooperate on matters of common interest, but without treaty based rules. Examples of such non treaty based cooperation, include cooperation on issues of financial sector stability through clubs such as the Financial Sector Stabilisation Board, cooperation on protocols for managing the Internet, cooperation in managing pandemics such as swine flu and the recent outbreak of Ebola in West Africa etc, and of course regional trade agreements outside the purview of the WTO.

A recent development, which could help improve global governance of both the hard and soft kind, is the establishment of the G 20 as the premier forum for discussion of international economic issues, replacing the G 8 which performed this role earlier.[1] The G 20 has no formal international legitimacy. It is essentially a self selected group and although broader than the G 8, which it replaced, it is not fully representative. However, it includes all the major emerging market countries and its members together account for 75 percent of global GDP and 80 percent of global trade. Where decisions are made on the basis of weighted voting, as is the case in organizations such as the IMF or the World Bank, the G20 can push through any decision on which they are all agreed. Where decisions are made by consensus, as in the WTO or the UNFCCC, the G20 cannot guarantee a successful outcome, but even in these organizations, a group representing an overwhelming proportion of the World's economy can be expected to have a decisive impact if they really adopt a common position.

I Managing Global Financial Interconnectivity

The explosion of financial flows around the world, with increasingly complex new financial instruments, is the consequence of the liberalization of capital controls by most countries over the past three decades, and it has created a powerful web of interconnectivity across countries. This can be a force for considerable good, but it can also pose serious threats to financial stability, both in individual countries and larger groups of countries. Effective systems of global governance are needed to (a) avoid a build up of fragility in the system which could easily lead to a crisis and (b) to establish a system for managing crises when they occur.

These problems have been recognized for some time, but until recently it was assumed that only emerging market countries needed to worry about a sudden reversal of capital flows triggering major balance of payments crises. Such crises were experienced in Mexico in 1994, Thailand, Malaysia, Indonesia and Korea, in 1997, Russia and Brazil in 1998 and Argentina in 2001. They were all attributed primarily to weaknesses in the domestic financial structures of these countries and to the pursuit of inconsistent policies, notably the desire to maintain a fixed exchange rate without the prerequisite of a well regulated financial system and a strong fiscal position. The crises led to (a) a greater appreciation of the need to improve policies in emerging market countries, especially in the matter of financial regulation and exchange rate flexibility and (b) a greater focus on the need to improve the speed with which the IMF could respond and also on the need to increase the size of quota resources. The Eleventh Quota review finalised in January 1998 increased total quota resources by 45% from SDR 135 billion to SDR 212 billion.

No one thought at the time that similar problems might arise in the industrialized countries themselves requiring IMF financial support. This is precisely what happened after 2008, and especially after the Eurozone Sovereign Debt crisis. After four decades of never having lent to any industrialized country the IMF had to lend to substantial amounts to many industrialized European countries to stem what looked like a rapidly escalating downward spiral. In this background it is relevant to ask whether the current system is strong enough to meet the challenges of the future.

The centre piece of the current architecture for managing the global economy is the International monetary Fund. It has two roles. It undertakes surveillance of the policies of its members to advise them on how best to achieve the objectives of stability and growth of the

[1] The process of widening the G8 was a gradual process. It began with the practice of inviting 5 countries (China, India, Brazil, Saudi Arabia and South Africa) to join some sessions of the G 8 Summits, not really already been as full members, but as Celso Amorin of Brazil put it, as a group "invited to join them for coffee after the dinner". The need to undertake consultations with emerging market countries as full members became urgent following the financial crisis in 2008. Since the G 20 had already been operating at the level of Finance Ministers since 1999, President Bush decided to convene the same group at the Heads of Government level in Washington DC in November 2008 to discuss the crisis and ways of containing it. The group was formally designated as a permanent group in Pittsburgh in 2009 to replace the G 8 for economic matters but not security issues which would remain with the G8

country, in a manner that is consistent with the objective of stability and growth and also a well performing international economy. It is also responsible for providing resources to manage crises when they arise, subject to appropriate polices designed to restore market confidence, and achieve financial stability and growth. The Fund has long experience in helping individual countries to deal with crises, and its experience in this area has been much studied, and often criticized, and many useful lessons have been learned. However, the task of managing a global crisis which could also involve industrialized countries poses new challenges. The question we have to ask is whether these arrangements are sufficient to manage the challenge of a hugely interconnected global economy.

Resources for the Fund

An immediate problem relates to the resources available to the Fund. The quota based resources available to the IMF at present are SDR 238 billion but of this only about SDR 190 billion are usable. The need to supplement these resources was recognized following the global crisis and the G20 gave an important lead in bringing about a consensus. The need to increase the Fund's own resources was signaled by the G 20 Summit in Pittsburgh in 2009. This was a change in the position taken earlier by the advanced countries that no increase in resources was necessary on the grounds that private capital markets would provide the resources needed to well managed countries and for those that were badly managed the existing resources with the Fund were sufficient. The outcome of this agreement, actively brokered by the G 20, was a successful conclusion of the Fourteenth Quota Review raising the total quota size to SDR 438 billion – the highest proportional increase ever.

Although the increase was quickly agreed through the IMF's normal procedures, with the US Administration strongly supporting the increase and indeed taking a lead in piloting it, the increase has yet to become operational because of the inability of the US Administration to get the Congress to authorize the US payment of its increased quota share.[2]

Along with the proposal to increase the total quota size, the G20 Summit in Pittsburgh also signaled the intention to increase the voting share of the dynamic emerging market countries by 5 percent with a corresponding reduction in the voting share of European countries. This restructuring was to be accompanied by a reduction in the n umber of European chairs in the Board. This was a major move in improving global governance responding to long standing demands from the emerging market countries that their voting share should be increased in line with their increasing economic weight in the world economy. It is also natural that this should be done by reducing the European share which at present is twice that of the US although the two economies are roughly the same size. It is really unfortunate that these major changes cannot be implemented until the US completes the ratification process. This has to be counted as a major disappointment in the functioning of global governance in this area.

Pending the increase in quota, the Fund's resources have been augmented by authorized borrowing under the New Arrangements to Borrow (NAB) and a number of bilateral borrowing arrangements with a number of countries. Together, these arrangements can provide SDR 390 billion in usable resources (more than twice the existing usable quota resources) to support Fund lending. However, reliance on borrowed resources obtained from member countries, which are subject to frequent review, is obviously not ideal.

The problems experienced with replenishing the resources of the Fund highlight the weaknesses in the system. It is cumbersome and time consuming and the 85 % majority rule for agreeing a quota increase is an anachronism which gives the US an effective veto which, even if not exercised by the US Administration, can be effectively exercised by the Congress. The US Congress is fully within its rights to withhold authorization for payment of the US quota but this should not hold up implementation of a quota increase when other countries are agreed and willing to pay. A reduction of the super majority requirement to say 75 % is clearly called for. It is obvious that if the quota increase is implemented and the US does not pay its share its voting share of 17 percent would be eroded. This threat alone would encourage Congress to pay as happened earlier when the 75 % rule was applicable.[3]

Once the Fourteenth Quota Review is made operational, it would take Fund quotas in relation to GDP and trade back to what they were in 2001. However it is arguable that this is not enough since even today, the total of the New Arrangements to Borrow and the Bilateral Borrowing arrangements provide the Fund with more than twice the existing usable quota resources and a doubling of quota resources would still leave the Fund with a need to rely on borrowed resources. The Fifteenth quota review, which is now due, should therefore be accelerated to provide the Fund with additional resources that would at least remove the need to rely on borrowed resources. Assuming that the Fourteenth Quota review is finally implemented, and the size of Fund quotas rises to SDR 438 billion, there is a strong case for aiming at double that level in the Fifteenth quota review. Work towards this outcome need not wait for ratification of the Fourteenth Quota Review

[2] Unfortunately, the increase under the Fourteenth Quota review can only become effective when members representing 85 percent of the total votes ratify the increase and this is held up because the US, which has a 17 percent share, is not able to get the US Congress to approve paying in the US share of the increase. The US Administration has strongly supported the quota increase, and indeed took the lead in getting the G 20 to agree to a large increase in quotas, but it has not been able to persuade the Congress to pass the appropriation needed to pay in the US share of the additional quota.

[3] See Rakesh Mohan (2015)

The system also needs to be made more automatic to enable the Fund to mobilize resources on a large scale if it suddenly becomes necessary to deal with a large crisis. The scale of intervention needed in industrialized countries in recent years has been truly massive. The IMF should be empowered to intervene on a large scale in exceptional circumstances. One way of doing this would be to empower the Board to create SDRs in favour of the Fund to support lending programs which cannot be supported with available Fund resources. Unlike decisions on IMF programs, which require only a simple majority, the decision to trigger a special issue of SDRs to support a program that is otherwise deemed necessary, but for which the normal resources available with the Fund are insufficient, should require a super majority of say 75 percent. This is high enough to satisfy those wanting such decisions to be taken only in exceptional situations, and also low enough not to give any one country a veto.

Needless to say, this change can be made only if the Articles can be amended, and this would require an 85 percent majority under present rules. This is not something that can be easily achieved, but it will be a test of global leadership whether such a systemic change can be made. This is an area where the G 20 could play a decisive role. In fact, it is impossible to believe that any such reform is possible unless a political consensus can be evolved in the G 20 at the Summit level.

In recent years there has been a tendency, encouraged by the IMF, to urge emerging market countries to protect themselves from crises by (a) building higher foreign exchange reserves, and (b) entering into regional swap arrangements. These options have important downsides. Some strengthening of reserves is certainly necessary, but to build reserves on the scale needed to deal with exceptional crisis situations is a negation of the logic of having an international system to help deal with these problems. It would call for very high levels of reserves, which would be either unnecessarily contractionary if the reserves are built up by running large current account surpluses, or unduly expensive if achieved by borrowing internationally at higher interest rates than would be earned by the reserves built up.

The proposal to rely upon swap arrangements is also fraught with problems because these arrangements often envisage lending in association with the IMF. Lending in association with regional arrangements can compromise the independence of the IMF especially if the regional grouping includes politically important countries. IMF participation in Troika programs in Greece is a case in point, where the IMF's certification that the programs were viable without a debt write off could be questioned and attributed to a desire to compromise with the views of European governments who have substantial voting power in the IMF[4].

The conclusion is inescapable. The IMF must be suitably strengthened to be able to support possible demands that could arise in crisis situations in a world which is increasingly interconnected. The simplest way of ensuring that the Fund can raise the resources it wants without resorting to cumbersome approvals is to allow it to create SDRs subject to a suitable super majority rule which does not give a veto to one country. However, this cannot substitute completely for quota increases. There is a case for a substantial increase in quotas in the Fifteenth General Review, with a further restructuring of the voting share of members, reducing the share of European countries to reflect their shrinking global weight. This means the quota increase should be non proportional.

Policies for Managing Crises

Financing is one part of crisis management but the other part is to put policies in place that can bring about an early recovery to normal growth. As noted above, the IMF has considerable experience in dealing with country specific crises and while its practice in specific instances has been much criticized, there is no doubt that important lessons have been learned. However, in the face of a global crisis, the policy corrections necessary are not just those which an individual country in need of assistance must adopt. Policy corrections are also needed by the systemically important countries which may not need assistance, but whose policies affect the global economy. Global governance in such a situation requires a coordination of policies by the major countries to put in place a mutually supportive set of policies that taken together are most likely to restore growth.

It is generally agreed that the G 20 were very successful initially in responding to the crisis in 2008 by orchestrating an agreement among the major countries to adopt an expansionary fiscal stance. The G 20 were able to persuade important European countries initially reluctant to adopt an expansionary position to do so in the interest of global recovery. In retrospect one can say they succeeded in the sense that they avoided a precipitous downward spiral in the global economy which was at that time not ruled out.

The G 20 have yet to succeed in bringing about policy coordination to stimulate a reasonable recovery. They did however recognize the need to build a workable system for multilateral coordination of policy among the major G 20 countries. The Pittsburgh Summit in November 2009 charged the Finance Ministers of the G20 were being charged with developing a Mutual Adjustment Process (MAP) based on consultations among the G 20 countries, with inputs from the Fund. Multilateral surveillance is part of the Fund's mandate and it implies that if there are global imbalances, it is necessary for the major economies to act in a coordinated manner to address them. The IMF had made an attempt to achieve such coordination in 2005 by undertaking a series of bilateral consultations with major countries but, as Raghuram Rajan the then Chief Economist of the IMF has said (see Rajan 2012) the effort was completely unsuccessful. All countries agreed there were global imbalances but they felt corrective steps had to be taken by other countries. The MAP process was supposed to be different. It would require the systemically important countries among the G 20 to quantify what they proposed to do, and the IMF was expected to indicate whether these actions would lead to the growth revival targeted. In the event the policy commitments were

[4] See for example Rakesh Mohan (2015)

inadequate, the countries would discuss multilaterally how to improve the outcome with the Fund helping to indicate how close they were getting.

The global economy has clearly not performed as the G 20 wanted and to that extent performance under the MAP has been disappointing. The country led process did lead to specific policy indications by individual countries. However, the IMF repeatedly stated that what was being promised would not achieve the revival of growth being targeted. Part of the problem was the existence of substantial differences of view on critical issues. These include (a) the fiscal stance that was appropriate for surplus countries (b) the pace of fiscal consolidation that is appropriate for deficit countries, and the impact such consolidation would have on growth (c) the actions needed to encourage economic efficiency in different countries to trigger a sufficient response in countries in terms of total factor productivity growth and investor sentiment and (c) the time lag in which the positive effects expected could be expected to roll out. It is easily seen that these are inherently difficult questions and any answer must be qualified by considerable uncertainty. Since political leaders typically have relatively short horizons, any course of action which involves immediate political costs but the benefits are uncertain in the short run is unlikely to be accepted.

Apart from the problem of getting agreement on a set of policies across countries, there is the traditional problem of the asymmetry between surplus countries and deficit countries. It is relatively easy to discipline deficit countries because they need to attract resources and discipline can be a condition of extending resource support. This raises the issue whether the conditions being enforced are well designed or mistaken but that is a separate issue. The real problem is that it is not easy to discipline surplus countries since they don't need resources and yet their policies which generate large surpluses are the mirror image of the problems in the deficit countries which generate large deficits. The resolution of global imbalances almost certainly involves action on both fronts but if deficit countries are unwilling to make the necessary changes for short term political reasons, the surplus countries are even more unwilling. This takes us back to Keynes' original proposals on the need for some measures to penalize countries that accumulate excessive balances reflecting unduly high surpluses.

Ted Truman of the Petersen Institute has suggested a "hard governance "solution to the problem involving empowering the IMF to implement a form of surveillance of the major systemically important countries that would define limits for key parameters, such as the current account surplus/deficit as a percentage of GDP for example, that countries should meet and countries running surpluses above some cut off percentage of GDP would be subjected to penalties of various sorts. There do not seem to be any takers for such hard governance solutions, but the alternative is to continue in the present soft governance mode.

Similar failures of coordination arise in connection with the use of monetary policy in industrialized countries especially the United States. The announcement in 2013 that the Fed would have to reverse its loose monetary policy stance led to a temper tantrum in international currency markets. Uncertainty about what the Fed will do continues to worry international markets and is a source of potential volatility. Given the systemic importance of the US economy it is inevitable that the stance of policy adopted by the Fed could have a powerful effect on global financial flows, subjecting emerging market countries to potential risk. The current system of global governance, including the MAP does not provide any realistic basis for actually coordinating action among the major central banks. There are mechanisms for consultations but since central bank actions have to be guided by a constant assessment of current circumstances it is difficult to imagine closer coordination.

Stabilising the Financial System

A critical lesson from the 2008 crisis is the need to ensure systemic stability in the financial sector through better financial regulation and with due attention to macro prudential considerations. Several steps have been taken in this regard by regulators acting in consultation with each other. The Basle III norms applicable to banks were finalized much faster than Basle II, and many countries have agreed to make them operational by 2018. Financial Stability Assessment Programs (FSAPs) for individual countries conducted by the IMF help to identify weaknesses of the system. Interestingly, no FSAP was conducted for the US before the 2008 crisis because the US did not think it was necessary. It is however fair to say that if it had been, it is unlikely that the weaknesses that led to the crisis would have been identified. After all, some of the potential instability created by the new financial instruments which proved to be highly toxic had been signaled in 2005 at the Jackson Hole Conference by Raghuram Rajan but the warning found few takers either among the participants or the IMF.

An important positive outcome of the Crisis was the conversion of the Financial Stability Forum, which was an informal forum at which finance ministries and regulators met to discuss regulatory issues related to financial stability, was converted into a more formal Financial Stability Board and its expansion to include all G 20 Members. This was an example of "soft governance" democratizing what was earlier seen as an exclusive club dominated by industrial countries. The involvement of emerging market countries will help create greater ownership of ideas that promote financial stability.

The Role of the SDR in Stabilising the System

An unresolved issue in discussions of the international financial architecture is the role of the SDR in stabilizing the international financial system. The discussion usually focuses on the need for some action to realize the hope embodied in the Second Amendment to the Articles of the Fund in 1975 that one of the objectives of the Fund was to make the SDR "the principal reserve asset" in the system. In practice however new issuances of the SDR have been infrequent and prior to the global crisis the SDR the total stock of SDRs had fallen to 0.5 percent of total reserves. The large increase in SDRs following the crisis raised this to just under 4 percent. The SDR is clearly nowhere near meeting the objective specified. There is need to rethink whether the objective continues to have relevance.

A distinction needs to be made between the role of the SDR as a means of providing countries an unconditional line of credit denominated in a basket of reserve currencies at a favourable interest rate – a role that is widely appreciated among developing countries – and the role of the SDR as the principle reserve asset. The logic behind the latter objective was simply to avoid the danger of currency instability arising from sudden shifts in the currency composition of reserves. It is equivalent to getting countries to agree that they will always hold their reserves of foreign currency in the same currency composition as the SDR basket. Years of discussion have established that countries are unwilling to surrender their foreign currency holdings (mainly consisting of dollar holdings) for equivalent holdings in SDRs unless a substitution account is established by the IMF, which would compensate them for losses that may arise because of exchange rate changes. This can only be done if the cost is borne either by individual countries whose currencies are surrendered by reserve holders for conversion into SDR reserves (in this case mainly the US) or alternatively by the Fund, which would mean all members in proportion to their quota size. The issue was last discussed in 1979 and no agreement could be reached.

It is not clear however that had the objective been achieved, it would have made a significant contribution to stabilizing the system. This is because changes in the currency composition of reserves are likely to be very modest compared with the size of private flows speculating on exchange rate changes. The total foreign exchange reserves of all countries in 2010 were only $ 4 trillion, and marginal changes in composition are unlikely to be very large. Besides, central banks, having converted their reserves into SDRs, would still be free to engage in derivative transactions which could negate the apparent stability contributed by the fixed composition of their reserve holdings.

The real role of the SDR is as a globally determined line of credit extended to all countries in proportion to their Fund quotas. This facility is greatly valued by developing countries even though the extent of the credit provided is modest. As noted above the total size of SDR holdings is only 4 percent of total reserves and most of this is held by industrialized countries who have extensive reserve pooling arrangements to help them to deal with exceptional situations. Nevertheless, its assured and unconditional availability can help in crisis situations, as became evident recently when Greece was able to meet the obligation to make a payment due to the IMF by drawing down its SDR balances. The best contribution that the SDR can make to stabilizing the system is if the Fund Board could be empowered, as proposed above, to create new SDRs in its favour to finance exceptional financing needs in the midst of a crisis should they arise.

Financing Investment in Infrastructure

While the international community has been understandably preoccupied with restoring growth in the industrialized countries, an equally important issue is the need for some special initiatives to finance much needed investment in infrastructure in developing countries. It is generally agreed that if developing countries are to achieve the kind of growth of GDP that they need to satisfy the expectations of their populations, they will have to invest much more in infrastructure. Investment levels in infrastructure in developing countries are currently estimated to be about $1 trillion per year, whereas the "requirements" have been variously estimated as $1.3 to 1.5 trillion (Fey et al), or $1.8 to 2.3 trillion (Bhatttacharya and Romani 2012) and even as high as $3 trillion (Bhattacharya and Holt forthcoming). Taking a mid point approach, it would seem that the investment deficit in infrastructure investment in developing countries can be put at $1 trillion per year or about ...percentage points of their GDP.

The G 20 Summit in Seoul in 2012, in an effort to put development financing issues firmly on the G 20 agenda, had emphasized the need for MDBs, and especially the World bank, to explore ways of financing investment in infrastructure in developing countries. Given the scale of the deficit, it is reasonable to think that the World Bank and other MDBs should play a major role in facilitating such investment. If they were to finance only 10 percent of the deficit, they would need to target infrastructure financing to increase by around $100 billion per year. This will not only help strengthen the supply side conditions for faster growth in the developing countries, it will also provide a much needed boost to aggregate demand in the world economy. Unfortunately, there has been little response in this area either from the industrialized countries or from the World Bank.

One consequence of the perceived unwillingness on the part of the industrialized countries to expand MDB lending, and more specifically World Bank lending, in infrastructure, is that some developing countries have taken the initiative to set up new development banks. The New Development Bank set up by the BRICs countries and the Asian Infrastructure Investment bank set up by China, but with participation by several countries, including many industrialized countries, are examples of this reaction. The need for infrastructure investment is so large that the new institutions can be welcomed on the grounds that there is room for more actors and experimentation with new forms of lending. However, this should not distract from the need to plan for an expanded role for the existing institutions.

The world is currently going through a period where there is massive liquidity in the financial system, thanks to a very loose monetary policy on the part of the major central banks. The low interest rates produced by excess liquidity were expected to stimulate investment but they have not done so. However, they provide a unique opportunity to channel available resources towards much needed investment in infrastructure in developing countries. A failure to utilize this opportunity could legitimately be called a failure of global governance in the financial area. It is sometimes argued that if there is ample liquidity then countries should be able to borrow on their own for bankable projects. And the real problem is the lack of bankable projects. It may well be true that there are gaps in project preparation, gaps in the ability to get private participation in infrastructure which would reduce the demand for government resources, gaps in the maturities for which finance is available, and also currency mismatches which, without adequate hedging instruments, makes it difficult to finance infrastructure projects which should ideally not borrow in foreign currencies.

Given the long experience that the World Bank has in financing infrastructure there is every reason to think that it should play a much larger role than is currently being contemplated. This is especially so in view of the need for major investments to make infrastructure greener. Many developing countries have made commitments to increase their dependence on renewable energy sources, and to attract private investment in this effort. The World Bank, especially the IFC, could be given a mandate to take a lead in financing such investments through the use of innovative financing mechanisms. The involvement of the Bank/IFC will greatly increase the willingness of private investors to get involved because it will reduce perceived political risk. From the country point of view the involvement of the Bank will give some assurance that the form of the concession arrangements are in line with global best practice. The World Bank has been criticized in some quarters that it is grossly overstaffed compared to other lending institutions – certainly the EBRD. A good way of responding to this criticism is to expand the operational programme. He G 20 could make a major contribution to global governance by refocusing the World Bank/IFC on infrastructure financing, with special emphasis on the need to help countries develop Green Infrastructure, using innovative financing mechanisms including lending in local currency with a suitable interest premium.

II Managing Trade Interconnectivity

The liberalization of trade across countries has long been regarded as a critical “win win” area, not only for the industrialized countries, but also for the developing countries. Historically, a large number of restrictions on trade were imposed by industrialized countries during the inter War period and this was recognized to have led to many of the economic problems, which led ultimately to the Second World War. Enlightened decision making after the conclusion of Second World War in the previous century triggered a series successful trade negotiations under the auspices of the GATT, to bring about a significant liberalization of trade. These negotiations, entered into mainly by the industrialized countries, produced a substantial liberalisation of trade with a reduction in tariffs on products of interest to these countries. The developing countries were not significant players at the time but they benefited from multilateral tariff reductions without much to lower tariffs themselves, under a general formula which acknowledged the need for special and differential treatment for developing countries. However, the other side of this bargain was that trade in agriculture, which was of interest to most developing countries, but was politically sensitive in industrialized countries, was never liberalized. It remained subject to entrenched domestic subsidy regimes in developed countries, with highly escalating tariffs in many agricultural processed foods, which operated to the disadvantage of the developing countries producing the raw material.

This asymmetry was meant to be addressed in the latest round of trade negotiations, the Doha Round, which was named the Doha Development Round precisely because it was meant to address the concerns of developing countries, especially regarding the removal of trade distorting subsidies in agriculture. The Round was launched in Doha in 2001 but it has made very little progress in the fourteen years since negotiations commenced! These fourteen years have seen tortuous negotiations and it is beyond the scope of this paper to make a critical review of why the negotiations stalled or to pronounce on which group of countries is more to blame. The fact is that the member states were not able to agree on many aspects, especially on the dismantling of the large trade distorting subsidies for agriculture in developed countries. At various times the EU, the US, China, India, Brazil and the African countries have all dug in their heels, with the result that no agreement has been reached.

The next Ministerial meeting is scheduled to be held in December in Nairobi but early indications are that no significant breakthrough is expected on any of the major issues under discussion ie domestic support for agriculture in industrialized countries, market access, NAMA and Services. Some efforts are being made to make some progress on issues concerning the least developed countries, but progress even on this is far from assured. Considering that trade has long been regarded as a critical lever for promoting development, and it has often been argued that trade is actually much more important than aid, and also that this Round was meant to address concerns of developing countries, the lack of progress can only be called profoundly disappointing.

A cynical view, increasingly expressed, is that the industrialized countries are no longer interested in the multilateral trade negotiations, either because negotiating an agreement on the basis of reaching consensus among 190 countries is unlikely to yield fruit or because their objectives now go beyond lowering border restrictions and seek deeper integration and harmonization behind the border. The United States is focusing its energies on concluding regional trade agreements such as the Trans Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership with Europe. Both of these agreements, but especially the TTIP, go much beyond lowering restrictive measures imposed at the border. These are examples of global cooperation which will ultimately be embedded in Treaties, but they do represent a sidelining of the ongoing multilateral trade negotiations.

The deadlock in the Multilateral Trade Negotiations reflects poorly on the capacity of the global system to make progress on an area widely regarded as critical for development and where progress could also send a strong confidence boosting signal. It is interesting to consider the role of the G 20 in trying to resolve this deadlock. The issue surfaced on several occasions in the G 20 Summits, and led to strong statements of the need for an early resolution of the Doha Development Round. However these commitments duly reflected in Summit Communiques have not led to concrete action at the negotiating tables and certainly no noticeable increase in flexibility on the part of the industrialized country trade negotiators.

The conclusion is inescapable. It is not the need for a consensus among 190 countries that has held up progress. The G 20 countries themselves have not been able to close the gap between their positions on several issues. If the G20 could actually come up with a workable compromise – and compromise involves give and take – it would be a major contribution to improving global governance. So far they have not even tried. Action has been left to the trade negotiators. Had they same thing been done at the time of the financial crisis, I doubt if there would have been as much progress as there has been, for all the gaps that still remain to be filled.

III Managing the Threat to Climate Change

The third area where global governance is urgently needed is managing the threat of climate change. Climate scientists are agreed that the continued and growing burning of fossil fuels is leading to a steady build up of CO2 in the atmosphere which will produce global warming on a scale that will have very seriously negative impacts on many countries. It is also agreed that the poorer countries in the tropics, and coastal communities everywhere, are most likely to be hardest hit. The scientific consensus is that an increase in temperature of more than 2 deg C above pre industrial levels would have very seriously advers consequences and must be avoided.

This issue has been discussed over many years in annual meetings of the UNFCCC with very little results. Until recently, the developing countries have argued that since it is the accumulation of Green House Gases (GHGs), of which Co2 is the most important, that is causing global warming, and since the overwhelming bulk of this accumulation is due to fossil fuel burnt by the industrialized countries during the process of their development, it is these countries that must bear the burden of reducing emissions. The developing countries have argued that they should not be under any obligation to reduce emissions except to the extent that they are compensated for the cost involved.

The next meeting of the Committee of Parties (CoP) is scheduled for December in Paris and there is some forward movement from the deadlock which has existed until now. As many as 150 countries, accounting for 90% of the global GHG emissions have made submissions of what are called Intended Nationally Determined Contributions (INDCs) towards mitigation action which they feel they can take. The group includes all the major developing countries, including China, India and Brazil. Some of them have made the actions proposed conditional on financing being made available, but the exact terms of the financing expected are vague. While this is indeed an advance, it is not exactly a firm international commitment. The use of the "intended" in INDCs implies something less a firm determination and the term "contribution" is also not a commitment. However, for the first time major countries have signaled that they will take some mitigation action.

The problem is that the actions indicated add up to much less than is required to reduce carbon emissions in total to an acceptable level. The International Energy Agency has estimated that the INDCs will reduce the *growth of emissions*, but what we need in order to achieve climate goals is to bring about an *absolute reduction* in total emissions, moving to zero net emissions for the world as whole by the end of the century. The world is very far from that position. A recent UN Report confirms the IEA assessment that the INDCs will slow the growth of emissions but it also warns that what is proposed is not enough and unless stronger action is taken, the increase in temperature by 2100 is more likely to be 2.7 degrees C. This is better than many had feared but it poses unacceptable risks.

One can be optimistic if one views the INDCs as a start, which gives the global community the opportunity to do better by taking stronger action in the period after 2025. In practice, the pace of progress in combining growth with slowing and ultimately reducing emissions will depend on how easy it is to (a) increase energy efficiency in various activities thus reducing the energy intensity of GDP and (b) shift to greener sources of energy to reduce the emissions intensity of energy and (c) provide additional financing to the developing countries to help lubricate mitigation action. Both (a) and (b) will be greatly aided by developments in technology which reduce the costs of making the shifts involved, and technology development will depend largely on what happens in industrialized countries, including the provbision of resources for such development. As for (c), there is a promise to deliver a mix of private and public sector financing amounting to $100 billion per year by 2020, but the total resources promised thus far are only $10 billion.

Reaching an acceptable level of mitigation action across countries will be a test of the international community's ability to deliver good global governance which can avoid what could be a catastrophic outcome on climate change. The difficulties in reaching such an agreement need to be clearly understood. . The benefits of mitigation action taken by an individual country are reflected in the reduction in the total stock of GHGs in the earth's atmosphere and as such the benefits do not accrue to the country itself, but to all countries. A pure country specific cost benefit calculus will therefore inevitably lead to each country taking less action than is economically justifiable from the point of view of the world. However, if action by individual countries can be globally coordinated, it should yield benefits to all which are considerably greater than the costs incurred.

The problem that arises is how to determine a fair sharing of the burden of mitigation. The formula sanctified in UNFCCC discussions thus far is “common but differentiated responsibility according to circumstances and capabilities”. This used to be interpreted by the developing countries in the way it was embodied in the Kyoto Protocol under which developing countries had no responsibility at all because their cumulative contributions to emissions were insignificant. Changing circumstances, which have made China the biggest emitter, with India third if the EU is not treated as a single group, have led the developing countries to start making some commitments as reflected in the INDCs. However, to achieve the objective of limiting the increase in temperature to 2 degrees C more action is needed and this requires a shared understanding of what is a fair sharing of burden.

The logical approach would be to try to define criteria that will meet the test of “fairness”. One approach could be to first agree on the carbon budget available to the world between now and some date by when carbon emissions must be reduced to zero world wide. This carbon budget must then be allocated across countries in a manner deemed to be fair. Countries would then have to commit to live within this budget in whatever way they choose. There are several practical issues that would have to be resolved to make this arrangement workable. These include issues of measurement and verification to determine whether countries have indeed lived within their limits, issues of penalties for non compliance, issues related to the tradability of emissions permits granted to each country etc. However these implementation issues only become relevant if we can first agree on how the available carbon budget should be allocated. Almost no work has been done on this issue and yet it is an essential step to reaching a solution. One can imagine different criteria. One would be to allocate the remaining carbon budget to different countries on an equal per capita basis. Another would be to relate emissions entitlements to the GDP produced with a preferential entitlement for lower income countries, and calibrating the total entitlement to fit within the carbon budget. There may be other approaches which deserve to be considered. Countries will clearly prefer criteria that favour them, but we do need an articulation of alternative possibilities.

This is perhaps an area where the G 20 could take an initiative. If nothing else, they could set up a High Level Committee, with access to the best expertise available, to submit a report to the G 20 outlining *alternative* approaches which should be considered. Unless something along these lines is done, it is difficult to see how successive CoP meetings of the UNFCCC can make significant progress on the difficult issue of burden sharing.

IV A Summary Assessment

In summary, it can be said that the increase in economic interconnectivity in several areas puts great pressure on the international community to develop institutions of global governance which can help to ensure that the policies of independent nations are sufficiently coordinated to ensure satisfactory global outcomes. We have evolved a number of institutions in each of the three areas considered in this paper: managing financial interconnectivity, trade connectivity, and interconnectivity on account of climate change. Operating outside the formal institutional forum for each of these areas is a new informal consultative group the G 20.

On balance it appears that the institutions dealing with financial interconnectivity have significant achievements to their credit, especially in the matter of dealing with crisis situations. However even in this area there are new challenges that need to be addressed. The institution dealing with trade interconnectivity, the erstwhile Gatt and now the WTO, played a major role in building a more open rule based trading system over many years, but it has been much less effective at least in the recent past, in dealing with long pending issues in the multilateral trade negotiations area. Climate change, poses the most potentially dangerous threat to the global community over the coming decades. The institution dealing with it, the UNFCCC, faces the most challenging task if only because democratic governments find it most difficult to take difficult decisions whose benefits will occur only over a long period and that too in terms of avoided costs rather than positive gains. On balance, the G 20 will show leadership by concentrating their energies to fill gaps in each of these areas as they arise.